

April 23, 2018

Clerk of the Board
California Air Resources Board
101 I Street
Sacramento, CA 95814

Submitted electronically to <http://www.arb.ca.gov/lispub/comm/bclist.php>

Re: CBL Markets Comments of on the 2018 Proposed Amendments to the Low-Carbon Fuel Standard Regulation

CBL Markets (CBL) is pleased to have the opportunity to provide comments on the 2018 Proposed Amendments to the Low Carbon Fuel Standard (LCFS) Regulation (Proposed Amendments).

As an operator of spot exchanges of environmental commodities, including spot cleared California Carbon Allowances (CCAs), CBL encourages the ARB to consider the benefits of cleared spot transactions as filling a niche between larger regulated entities who predominantly trade futures and the small-to-mid size entities at the forefront of alternative and renewable fuel production many of which do not have access to futures and derivatives markets.

Specifically, CBL encourages ARB to:

- Adopt the proposed amendments allowing exchange clearing service provider accounts in the LRT-CBTS, and thereby allowing temporary custodial ownership of LCFS credits for clearing/escrow purposes.
- Adopt eligibility requirements that enable both spot and futures exchanges and clearing services by removing the requirement of CFTC registration for spot exchanges.
- Allow spot exchanges and clearing services providers to hold LCFS units on behalf of sellers for up to 30 days to allow ample time to discover fair market value for their credits and minimize administrative burden of weekly transfers in the LRT-CBTS.

Below are the reasons CBL supports the proposed changes, and further recommendations for modifications to these Proposed Amendments to ensure all market participants are able to benefit from the price transparency and level-playing field that spot exchanges provide for all market participants, including sophisticated and unsophisticated as well as large and small.

CBL Background

CBL Markets operates a spot exchange trading platform for the physical trading of multiple environmental commodities, including the global voluntary carbon market (CAR, ACR, VCS and Gold Standard), compliance carbon allowances in the Western Climate Initiative (WCI) and Regional Greenhouse Gas Initiative (RGGI), renewable energy certificates (RECs) in Australia and North America. CBL also operates an exchange for water allocations and entitlements in the Australia water market.

All together CBL clears spot trades for more than 200 environmental commodities, serving more than 300 customers in Australia, North America and Europe.

As an exchange CBL's goal to increase market efficiency, lower transaction costs, increase transparency and efficiency by lowering the barrier to entry, increasing access to counterparties to drive increased liquidity.

CBL is excited to support the LCFS and more broadly transportation electrification in North America. We hope to make it easier for all market participants, including small and renewable fuel producers in California, to gain access to fair market value with the level-playing field that exchanges provide, even if they do not have access to futures exchanges.

How We Operate

The CBL spot exchange electronically matches bids and offers that are submitted via a web-based interface. Only CBL member participants who have the relevant registry accounts (an active LRT-CBTS account for example) and have passed our know-your client (KYC) process can access the CBL platform.

An unique feature of the CBL platform is that to submit a bid a seller must post the units they plan to sell in a registry account that has been designated to ensure the units are available for sale and the buyer must post cash in a clearing account equal to the offer for units to ensure the funds are available. In this way CBL pre-clears all trading activity, mitigating any counterparty or default risk.

When a bid and offer match, a trade occurs as a pending transaction subject to the clearing and settlement process. CBL clears the transaction by ensuring that 1) the buyer has funds in their settlement account, and 2) the seller has units in the appropriate Registry account. CBL then

settles the transaction by transferring the cleared funds to the seller and the cleared units to the buyer.

Benefits of a Spot Cleared Market

CBL Markets intends to provide a spot market for the LCFS credit market, which will have numerous benefits to regulated parties, low carbon intensity fuel producers, investors and the program at large, as outlined in this section.

A spot market refers to a market in which products are sold for cash and physically settled immediately. Spot transactions can take place on an exchange or over-the-counter (“OTC”), with exchanges providing the most secure, efficient and cost effective means of trading.

A futures contract is a contract used by parties to transact a set of physical commodities or emissions allowances/offsets for future delivery at a particular price, resulting in the creation of an obligation to settle. Futures contracts are traded on approved exchanges and generally require that holders of futures contracts maintain cash margin accounts to safeguard all parties against movements in the market. Spot and futures markets complement each other by expanding access to exchange trading by both covered and non-covered entities of all sizes in a fair and orderly market where everyone is on equal footing.

Unlike a cap-and-trade program wherein the aim is solely to reduce CO₂ emissions at identified sources, LCFS and REC programs aim to incentivize the market to invest in and develop renewable energy and fuels projects from a multitude of sources. As a result, the participants in the LCFS program, like in REC markets, are much more varied and diverse, resulting in a multitude of potential counterparties, from large multinational companies to small fuel producers. Many renewable fuel producers and credit originators like installers of electric vehicle charging stations or owners of electric forklift fleets are often smaller and newer entities that are not likely to be set up to trade futures.

Futures and derivatives exchanges, while serving an important role, require sophistication and substantial capital resources from participants in order to maintain daily cash margin requirements on open futures positions and to manage against price volatility. This is inherently more complicated for small-to-medium enterprises that might not have the staff and resources to access futures and derivatives.

Futures markets are well suited to enable large, sophisticated entities to hedge their exposure to changing prices. However, in many cases producers of renewable fuels are less likely to have

the creditworthiness, balance sheet requirements or sophistication to participate in these markets. Moreover, many of these fuel producers will seek immediate monetization of their LCFS credits as they are generated to cover operating costs and debt service. A physical, pre-cleared spot market offers a lower barrier-to-entry option for smaller entities to efficiently monetize the credits they generate, freeing up capital to invest in additional development of low carbon intensity fuels.

Lower Barriers to Entry

An exchange traded spot market ensures equal access to fair market value for all participants by enabling smaller non-covered entities, such as renewable fuel producers, and smaller covered entities, such as Community Choice Aggregators, municipal utilities and local agencies to access the market at a reduced cost without prohibitive barriers to entry. Exchange traded spot markets will provide participants in the LCFS Market (including covered and non-covered entities, credit originators and brokers):

- Standardized rules and contracts for a fair, orderly and transparent marketplace;
- Real time price discovery;
- Confidence of a secure clearing and settlement arrangement;
- Reduced long-term capital requirements associated with derivatives products;
- Market data and analytics.

CBL believes greater access and efficiency will increase confidence in the market-based components of the LCFS program, which will lead to:

- The development of a clear carbon intensity (CI) price signal for the fuel market;
- Greater efficiency in the market such that the covered entities will be able to meet their obligations efficiently with less cost to the end-consumer; and
- Increased investment in alternative fuel development, enabling least cost compliance with the LCFS program.

Specific Comments and Recommendations Regarding the Proposed Updates to the LCFS Regulation

Section 95483(a)(3)(A) CBL commends the ARB for recognizing the current regulation prevents trading on exchanges. We fully support the ARB in proposing eligibility requirements for entities that seek to provide clearing services for the LCFS credit market. We encourage the ARB and staff to adopt eligibility requirements that allow for both spot and futures clearing services and exchange trading.

The changes to the LCFS program as currently proposed would prevent spot exchanges to provide clearing services in the LRT-CBTS. Specifically, the requirement that an entity seeking to provide clearing services be registered with the Commodities Futures Trading Commission (CFTC) as a derivatives clearing organization (DCO) would prevent the development of spot exchange trading as spot exchanges are explicitly not regulated by the CFTC. Therefore, there it is not possible for spot exchanges to meet such an obligation.

We request ARB to not apply the same requirement in 95483.1(a)(3)(A) to spot market clearing service providers, who do not operate under the jurisdiction of the CFTC.

Similar to renewable energy markets, the LCFS market is very broad with many small and medium credit generators and fuel producers that might not be able to trade futures. Therefore requirements that enable both spot and futures exchanges would provide the most flexibility and access to the wide variety of LCFS market participants and lead to greater transparency and liquidity for all participants.

Section 95483(a)(3)(B) CBL encourages the ARB to reconsider the requirement that a clearing service provider only hold LCFS credits for up to 5 days in the LRT-CBTS for spot exchanges. This would benefit the market at large by:

- Allow for physical pre-clearing of sellers LCFS credits
- Eliminate counterparty delivery risk for buyers on an exchange;
- Ensure delivery of LCFS credits to buyers, maintaining anonymity between buyers and sellers

Therefore, CBL requests that the updates to the regulation allow for spot exchanges and clearing service providers to hold LCFS credits on behalf of approved exchange participants for up to 30 days. This will enable greater transparency and price discovery by giving sellers additional time and flexibility to find fair market value for their credits and monetize them securely and efficiently.

Conclusion

CBL applauds the California Air Resources Board and its staff's continued support of market-based mechanisms in developing proposed LCFS amendment language that supports and encourages the expanded use exchange trading and clearing services for LCFS transactions and transfers. We are confident that a robust cleared spot market would be a tremendous benefit to large and small LCFS markets participants alike. Larger entities would be able to trade with smaller less creditworthy counterparties via an exchange acting as a central counterparty. Small

and midsize covered entities and credit generators would be able to access fair market value without having to take a discounted price due to the pains of contracting over-the-counter for small volume transactions. To this end, we appreciate ARB's consideration of our proposed amendments to the regulations.

Thank you again for the opportunity to provide comments on the Proposed Amendments. If you should have any questions or seek clarification on any of the above, please do not hesitate to contact us.

Sincerely,



Scott Hernandez
Senior Vice President, North America
CBL Markets
450 Lexington Avenue, 4th Fl
New York, NY 10017